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January 30, 2002

Social Security Privatization is Bad for Minorities

Dear Democratic Colleague:

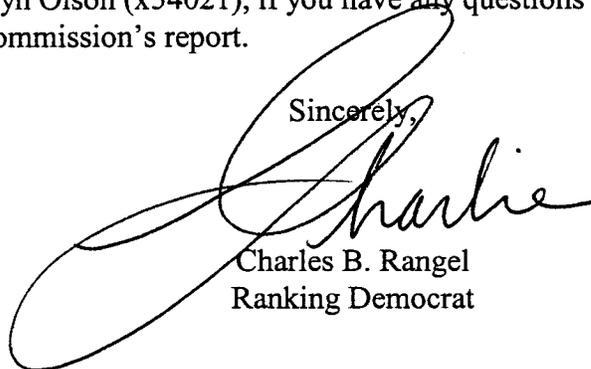
Late last year, President Bush's Social Security commission released its final report. This report called for benefit cuts, a retirement age increase, and substantial general revenue subsidies (or long-term borrowing) to pay for privatizing Social Security.

The commission's report included a number of statements about the benefits of substituting private savings accounts for Social Security's guaranteed income. One of these is the assertion that Social Security as it stands today is a "bad deal" for minorities, and that privatizing it would be beneficial to such groups.

This is simply incorrect. The attached fact sheet outlines what is at stake in the privatization debate for people of color, as well as anyone else who depends on Social Security to provide a secure income in old age, or in the event of disability or death.

Please do not hesitate to contact me or the Democratic staff director of the Social Security Subcommittee, Kathryn Olson (x54021), if you have any questions about Social Security privatization or the commission's report.

Sincerely,



Charles B. Rangel
Ranking Democrat

African Americans & Privatization: What's at Stake

The President's Commission to Strengthen Social Security released its final report on December 21, 2001. The report contained 3 plans that would partially privatize Social Security by diverting funds away from the system to create private savings accounts.

As part of the sales pitch for these privatization plans, the Commission claimed that Social Security was a bad deal for African Americans. It argued that, since African Americans have shorter life expectancies on average than other U.S. workers, they are more likely to die before they receive any benefits from Social Security. The Commission claimed therefore that African Americans would fare better with private accounts than Social Security, because they would have the opportunity to generate wealth that could be passed on to their heirs.

This argument, however, ignores the many benefits African Americans receive from Social Security today – benefits that would erode under a private accounts system. It overstates the impact of higher death rates among African Americans. And it fails to account for the reduction in current income that is the price of generating wealth.

Social Security today provides vital benefits for African Americans:

- Social Security has a **progressive benefit structure** which provides higher benefits, relative to earnings, for lower-wage earners than higher-wage earners. Social Security benefits replace a larger percentage of pre-retirement earnings for those with lower lifetime earnings than for those with higher earnings. Median earnings for African Americans were about \$15,000 in 1996, while the median for the general population was \$19,000. Thus, this feature of Social Security provides greater benefits to African Americans than the general population.
- Social Security provides **dependable monthly income**. Social Security benefits arrive on time, in the same amount each month. They do not fluctuate with the stock market, and they are automatically adjusted each year for inflation. This predictability is especially important for those who rely on Social Security to provide the bulk of retirement income, and who have modest incomes. On average, Social Security provides about three-quarters of all retirement income for African-American seniors. For 1 in 2 African American seniors, Social Security provides 90 percent or more of their total income. The median income of African American seniors is modest – in 1998, it was less than \$8,000 for singles, and about \$22,000 for married couples. With such modest budgets, a guaranteed monthly benefit is especially important, since there is little room to cut should income drop unexpectedly.
- Social Security provides **disability and survivors benefits** that are unmatched in the private sector. This protection is especially important for African Americans, who

have higher rates of career-ending disability or premature death. African Americans comprise only 12 percent of the U.S. population, but account for 17 percent of the Social Security disability beneficiaries and 22 percent of all children receiving Social Security survivor benefits.

- Social Security is **family insurance**. Those who are financially dependent on a breadwinner who dies, becomes disabled, or retires are entitled to receive benefits. These include the spouse, minor children, and adult children who were disabled as children. These benefits are particularly important to African American families: nearly one-fifth of all African Americans who receive Social Security benefits are children.
- **Early-retirement benefits** are available at age 62, and widow's benefits are available at age 60. This is an additional protection for workers and spouses who may have shorter life expectancies. This feature of Social Security increases the total benefits they would receive throughout their lifetimes. Two-thirds of all retirees take early retirement.

African Americans would be greatly disadvantaged under private accounts:

- ***Privatization dramatically worsens the financial condition of Social Security and requires significant cuts in guaranteed benefits.*** Social Security is already facing financial problems in the next 30 years. But privatization plans that "carve out" private accounts from Social Security – such as those proposed by the President's commission – would divert monies from the Trust Funds to pay for private accounts. This would only worsen the funding problem. For example, diverting just 2 percentage points of the FICA tax would cost the Trust Funds \$1 trillion over the next decade. This cost means that plans to privatize Social Security inevitably include steep cuts in guaranteed benefits.
 - A study by The Century Foundation revealed that a privatized Social Security system in which workers divert 2 percentage points of the current payroll tax into private accounts would require cuts in future Social Security benefits of 54 percent for single, average-wage workers age 30 and younger in 2002.
 - The privatization plans developed by the President's commission also require benefit cuts: a 40 percent reduction in retirement benefits, cuts in disability benefits, and a disguised increase in the retirement age are among the cutbacks proposed by the commission. These cuts would apply to everyone, not just those who chose to have an individual account.
- ***Private accounts erode the progressivity of the Social Security system, harming low earners.*** Under a privatized system, non-progressive private accounts would be substituted for progressive Social Security benefits. That is, Social Security

benefits – which are calculated based on a formula that favors low earners – would be significantly reduced, while individual accounts that do not favor low earners would be substituted. Low earners would lose part of the extra boost provided by Social Security's current benefit formula.

- ***Privatization means cuts in disability and survivor benefits; the accounts cannot make up for the loss of those benefits.*** The reason the Commission cites as to why Social Security is a bad deal for minorities – shorter life expectancy – is the very reason African Americans benefit greatly from the current system. Shorter life expectancy means higher rates of reliance on disability and survivor benefits. Indeed, 46 percent of African Americans who are receiving Social Security benefits do so under the disability and survivor programs. Yet these benefits would be reduced under privatization. The plans developed by the President's commission include cuts in disability benefits. However, a worker who becomes disabled has fewer years in which to contribute to an account. And under the commission's plans, disabled workers would not be able to use the funds in their accounts until they reached retirement age. Finally, no savings account – which is a fixed pot of money – can match the insurance protection provided by Social Security, which pays benefits for life to eligible workers and any dependent family members, and which is fully adjusted for inflation.
- ***Low-wage workers are unlikely to accumulate very much wealth, and may receive lower rates of return than other workers.*** Those with low lifetime wages are more likely to experience periods of time outside the labor force due to unemployment or disability, which would limit the amount of wealth they could accumulate in private accounts.

In addition, a study by the U.S. General Accounting Office (GAO) found that those with lower incomes tend to invest more conservatively. This may be a wise strategy – since more of their total income is at stake, and because they have few other resources to cushion losses if they invested in higher-earning but more volatile instruments – but it also means lower returns and less wealth accumulation.

- ***To build wealth, current income must be given up.*** Privatization isn't a form of alchemy that simultaneously allows the same dollar to be used once as income and again to create wealth. Wealth is created out of income; to create wealth, one must reduce the amount of income spent for current living expenses and set these savings aside.

The commission proposes that wealth be created (in individual accounts) by cutting Social Security benefits, which reduces the income of beneficiaries. The commission also suggests that retirees could pass wealth on to their heirs. However, any wealth that is passed on to a retiree's heirs would have to come at the expense of the retiree's current income – because every dollar that is set aside as a bequest for an heir is one

dollar less of income to live on. In both cases, the same dollar cannot be used both as income to meet current needs and saved as wealth.

The commission's claims about lower life expectancy are at odds with what researchers and advocates have found:

- The U.S. General Accounting Office reported:

“The consensus among researchers is generally that the progressivity of the benefit formula outweighs the negative effect of lower life expectancy for blacks in terms of what they receive from Social Security relative to what they contribute.” U.S. General Accounting Office, *Social Security and Minorities: Current Benefits and Implications of Reform*, Statement of Cynthia M. Fagnoni, Director of Income Security Issues, February 10, 1999. GAO/T-HEHS-99-60, p. 3

- The National Urban League said:

“Calculations that suggest a low rate of return on FICA taxes for African Americans also tend to misrepresent the nature of the lower life expectancy of African Americans. Differences in mortality between whites and African Americans, and hence life expectancy, are greatest for African Americans in their twenties and thirties. That set of workers has low earnings, and would accumulate very little value in individual accounts. Regretfully, those workers do leave behind families with children. Maintaining the insurance and family based benefit structure of the OASD [Old-Age, Survivors and Disability] Insurance program is vital for the fairness of the program to African Americans.” National Urban League, *The Impact of Social Security on Child Poverty*, introduction by William Spriggs, Director of Research and Public Policy, May 2000.

Finally, is privatization the best way to address the lower life expectancy of African Americans? Privatization of Social Security scales back the very features of Social Security that benefit African Americans the most, in exchange for questionable gains from a private account. Perhaps this problem is better attacked head on, by getting at the root causes of lower life expectancy: poverty, lack of health care, discrimination and exposure to violence. Social Security privatization costs over a trillion dollars in just the first 10 years. Is that the best way to use these resources?